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RESEARCH SUMMARY

A TALE OF THREE TAXPAYERS

Have income tax cuts really favored the wealthy at the expense of middle- and lower-income earners? Much of the popular rhetoric says they have; as one 2011 article puts it: "The effective tax burdens on the wealthy are lower now than at almost any time in the past fifty years, thanks to past rate cuts and a proliferation of tax exemptions which . . . shower most of their benefits on the affluent." Yet analysts can parse tax data in various ways to prove or disprove this point.

A new study published by the Mercatus Center at George Mason University takes a fresh approach to addressing the question. It examines how income tax burdens have changed over the past six decades for three hypothetical, but typical, households: (1) a low-income single mother; (2) a middle-income family; and (3) a family with income near the top 1 percent. The results are informative and somewhat surprising—and cannot be summarized in a simple slogan.

Below is a brief summary. Please see "A Tale of Three Taxpayers" to read the study in its entirety and learn more about author Cecil E. Bohanon, a professor of economics at Ball State University.

KEY POINTS

Over the past six decades, total individual income tax collections—the largest source of federal government revenue—have remained fairly stable as a share of the economy, averaging 7.6 percent of gross domestic product (GDP) in the 1950s and 1960s, and 8.2 percent from the 1970s through the first decade of the 21st century. This stability is striking, considering the numerous changes in income tax policies over the period. The marginal tax rates on the top income earners have plunged from a high of 91 percent as recently as 1963 to the current 39.6 percent. Yet other taxpayers benefited as well: since the 1950s, tax rates have generally been cut across all brackets and brackets have been consolidated several times.

To compare each of the three hypothetical households in this discussion, their income, deduction status, and tax liability are estimated for 2013, and their pretax earnings and deductions are held constant in inflation-adjusted terms for 1953, 1973, and 1993.

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Low-Income Single Mother with Two Children

In this household, the mother's 2013 adjusted gross income is $24,412, or 125 percent of the federal poverty line. Her children are eligible for subsidized school lunches and other government benefits that are not included in these income tax calculations.

- The low-income single mother's income tax liability would have risen from 3.0 percent in 1953 to 5.3 percent in 1973, only to decline to a *minus* 2.9 percent in 1993 and a *minus* 18.8 percent in 2013—making her a net *beneficiary* of the tax code changes since 1973, with negative taxes in 2013 of $4,594.

- Her claim to negative taxes has resulted mainly from the earned income tax credit (EITC) and the child tax credit (CTC). The EITC is "refundable," meaning those for whom the credit is larger than their tax liability receive a check for the balance. The CTC also is refundable in some cases.

- Like many federal benefits intended to help the working poor, the EITC is "means tested." Consequently, if this mother increases her earnings, her EITC benefit will shrink.

Middle-Income Couple with Two Children

This married couple has an adjusted gross income of $50,000, close to the median household income for 2013. They file a joint return, receive four exemptions, and take the standard deduction and all available credits.

- The income tax liability for such a household rose slightly from 1953 through 1973—from 10.4 percent of their income to 10.7 percent—but then plummeted over the next 20 years, to 2.7 percent in 2013.

- Like the low-income single mother with two children, this couple is a net *beneficiary* of the tax code changes since 1973, although their tax liability was positive during the entire time period.

- This household also saves $2,000 because of the child tax credit, but does not benefit from the EITC; their income is just above the threshold ($48,378) for qualifying for the latter.

Upper-Income Couple with Two Children

This married couple's adjusted gross income in 2013 was $350,000, putting them close to the top 1 percent of all households filing returns. Their income is too high to qualify for either the EITC or the CTC.

- The income tax burden for this household dropped from 27.2 percent of their income in 1953 to 20.2 percent in 1973. It rose slightly over the next 20 years, to 21.8 percent in 1993, but then declined again, to 19.3 percent in 2013.

- Overall, their tax liability is about 29 percent less than it would be if the 1953 tax code had remained in place.

- This decline in tax liability resulted entirely from reductions in marginal income tax rates, and most of them from *before* the Reagan administration.

Who Got the Biggest Tax Break?

As the figures show, all three households benefitted from tax reductions, but who fared best depends on how one reads the numbers.

- In dollar terms, the upper-income household's tax break is larger because the couple earns more and pays more in taxes to begin with. They saved $27,788 in 2013 compared to what they would have paid under the 1953 tax code. That amount is more than the single mother's total 2013 earnings of $24,412.

- In terms of percentage of income, however, the single mother gained the most. Her disposable income in 2013 is 24 percent greater than it would have been under the 1953 tax code. That compares with a 7.7 percent increase for the middle-income household, and a 7.9 percent increase for the upper-income household.

- While not the biggest winner—their savings in dollar terms ($3,848) and percentage of total income are lower than those of the other two—the middle-income household enjoyed a sharp decline in their income tax liability. By 2013, their tax burden was about 25 percent of what it would have been if the 1953 tax code had remained unchanged.

How Does Everyone Get a Tax Break?

If all three households are paying less in taxes than in the past, how did federal income tax revenue remain fairly constant? The answer lies in the growth of per-capita GDP, which correlates to household income.

- Over the decades, real income rose for most households. Measured in constant 2009 dollars, per capita GDP increased more than threefold, from $16,037 in 1953 to $49,283 in 2012.

- This growth in income also pushed most households into higher tax brackets, which helped maintain tax revenue collections while tax rates were cut.